## AUDITOR'S REPORT OF THE AUDITOR-GENERAL TO THE KWAZULU-NATAL PROVINCIAL LEGISLATURE AND THE COUNCIL ON eDUMBE MUNICIPALITY

## REPORT ON THE FINANCIAL STATEMENTS

### Introduction

1. I was engaged to audit the accompanying financial statements of the eDumbe Municipality, which comprise the statement of financial position as at 30 June 2010, and the statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, a summary of significant accounting policies and other explanatory information, as set out on pages XX to XX.

### Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and in the manner required by the Local Government: Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2009 (Act No. 12 of 2009) (DoRA). This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

### Auditor-General's responsibility

3. As required by section 188 of the Constitution of South Africa, 1996 (Act No. 108 of 1996), section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) of the MFMA, my responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with International Standards on Auditing and *General Notice 1570 of 2009 issued in Government Gazette 32758 of 27 November 2009*. Because of the matters described in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

### Basis for disclaimer of opinion

### Reserves

4. Reserves totalling R41,145 million was noted in the entity's financial records but could not be traced to the financial statements. In this regard, no approval, explanations and/or documentation in support of these amounts or transactions could be provided. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the fair presentation of the financial statements with respect to the disclosure of reserves.

### Property, plant and equipment

5. The municipality did not maintain a proper and GRAP compliant fixed asset register. Consequently, I was unable to obtain sufficient evidence in support of the completeness, valuation and existence of assets totalling R36,415 million, as disclosed in note 2 to the financial statements. Unexplained and unsupported differences totalling R4,521 million existed between the asset register and financial statements. Furthermore, alternative audit procedures could not be performed to support the completeness and accuracy of

depreciation, as an asset listing submitted for the first time on 3 November 2010, did not contain sufficient information per asset, to enable the auditors to perform a recalculation of depreciation.

6. The entity could not provide sufficient appropriate audit evidence to support journal adjustments of R547 938 relating to asset disposals. There were no satisfactory alternative audit procedures that I could perform to obtain sufficient appropriate audit evidence to satisfy myself as to the rights, existence, valuation and completeness of this amount as presented in note 2 to the financial statements.

**Finance leases**

7. Lease agreements and sufficient appropriate audit evidence could not be obtained for finance leases amounting to R809 499 (2009: R436 172), which is disclosed in note 8 to the financial statements. Furthermore, SA Standards of GRAP, GRAP 13, *Leases* requires a lease to be classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership. The entity is party to certain lease agreements that constitute operating leases, but which have been accounted for as finance leases. I was unable to satisfy myself as to the completeness, valuation and classification of finance leases, as presented in the financial statements.

**Capital work in progress**

8. The entity could not provide sufficient appropriate audit evidence to support adjustments of R3,319 million to capital work in progress. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that all work in progress were properly recorded. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the rights, existence, valuation and completeness of this amount as disclosed in note 2 to the financial statements.

**Receivables**

9. Included in consumer debtors of R48,205 million in note 6 to the financial statements is an amount of R36,198 million relating to bad debt impairment. This impairment was based on a council decision to reduce rates debtors and furthermore, to provide for outstanding debtors for various aging categories at year-end, without being supported by risk assessments and assumptions. Consequently, the accounting officer did not comply with South African Statement of Generally Accepted Accounting Practice (SA Statement of GAAP) and IAS 39 (AC 133), *Financial Instruments: Recognition and Measurement.* Consequently, I did not obtain sufficient appropriate evidence through alternative procedures to satisfy myself as to the valuation of consumer debtors and the related impairment loss.
10. I did not obtain sufficient appropriate evidence to satisfy myself as to the valuation of trade and other receivables totalling R60 358. The completeness of refuse debtors of R36,815 million could not be ascertained due to debtors being billed for only certain months or not billed at all. Furthermore, unexplained and unsupported negative debtors balances totalling R1,159 million were reflected in note 5 to the financial statements. Consequently, I was unable to satisfy myself as the valuation, existence, completeness and rights of these balances.

**Trade and other payables**

11. The entity could not provide sufficient appropriate audit evidence to support journal entries of R2,090 million to trade and other payables. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that all trade and other payables were properly recorded. Furthermore, an amount of R4,486 million was allocated to the creditors suspense account. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the obligation, existence, valuation and completeness of trade and other payables.

**Provisions**

12. The entity could not provide sufficient appropriate audit evidence to support provisions totalling R2,052 million. Furthermore, unexplained differences totalling R2,654 million existed between the entity's financial records and note 10 to the financial statements. Consequently, I was unable to satisfy myself as to the completeness, valuation and obligation of provisions.

**Value added tax (VAT)**

13. The municipality did not maintain proper supporting records, schedules and supporting documentation for journal entries processed to satisfy the completeness and valuation of VAT payable totalling R2,032 million, as disclosed in note 13 to the financial statements. Alternative audit procedures could not be performed to support the completeness of VAT payable and receivable on a monthly basis as individual transactions were not captured in the general ledger.

**Clearing/ suspense accounts**

14. Sources of the transactions in a clearing account should be readily identifiable, as well as monthly reconciliation's must be performed to confirm the balance of the account. This information could not be provided for clearing/ suspense accounts totalling R694 020. The entity's records did not permit the application of alternative audit procedures regarding these clearing/ suspense accounts. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the existence, obligation, completeness, valuation, accuracy, occurrence and allocation of these clearing/ suspense accounts.

**Revenue**

15. I did not obtain all the information and explanations I considered necessary to satisfy myself as to the completeness, occurrence and accuracy of amounts for the sale of electricity totalling R13,228 million, other income totalling R2,766 million, fines totalling R364 560, penalties and collection charges totalling R202 830 and other service charges totalling R2 317. In this regard, explanations, reconciliations, registers and documentation could not be provided in support of or for the differences noted. Moreover, the entity's records did not permit the application of alternative audit procedures.

16. Trading interest totalling R948 019 could not be traced to supporting documentation. Consequently, I did not obtain sufficient appropriate audit evidence as to the completeness, accuracy and occurrence of trading interest.

**Electricity distribution losses**

17. The municipality did not quantify and disclose electricity distribution losses in the financial statements, as required by section 125(2)(d) of the MFMA. The municipality's records did not permit the application of alternative audit procedures regarding the distribution losses. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the accuracy and completeness of these losses. Furthermore, the municipality did not monitor and record electricity distribution losses during the year under review.

**Expenditure**

18. I did not obtain sufficient appropriate audit evidence to satisfy myself as to the occurrence, completeness, accuracy, cut-off and classification of expenditure, as the entity could not provide sufficient appropriate audit evidence to support journal entries of R2,118 million (2009: R1,974 million), respectively to expenditure. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that all expenditure was properly recorded.

**Grants**

19. I did not obtain sufficient appropriate supporting documentation and/or explanations to support negative unspent grants totalling R1,015 million. Furthermore, differences existed between the general ledger and trial balance, working papers and actual amounts received by the municipality. No explanations could be provided in this regard. A further unsupported /unexplained difference of R5,206 million was noted between the financial statements and the general ledger.

**Accumulated surplus**

20. The entity could not provide sufficient appropriate audit evidence to support adjustments R2,710 million to the opening balance of accumulated surplus. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance of the accuracy, completeness, classification and occurrence of these adjustments, as presented in note 31 to the financial statements.

**Commitments**

21. There was no contract management system in place for the identification and recognition of contracts and there were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that all commitments were properly recorded. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness of commitments of R300 000, as stated in note 28 to the financial statements. Furthermore, commitments totalling R530 000 relating to a guarantee was not disclosed in the financial statements.

**Unauthorised expenditure**

22. The municipality has incurred unauthorised expenditure of R37,018 million as a result of overspending on its budget totalling R35,728 million. Furthermore, payments totalling R1,290 million were made prior to delegated officials approving them.

**Fruitless and wasteful expenditure**

23. Fruitless and wasteful expenditure totalling R290 900 was incurred, as a result of late payments to suppliers and interest on bank overdraft. Disclosure of this expenditure was not made in the financial statements.

**Irregular expenditure**

24. Irregular expenditure, totalling R19,061 million, has occurred as a result of the municipality contravening legislated supply chain management practices. This was not disclosed in the financial statements.

**Going concern**

25. The municipality incurred a net operating loss of R25,009 million at 30 June 2010. These conditions along with other matters indicate the existence of material uncertainty that may cast significant doubt on the municipality's ability to operate as a going concern. Further conditions included late payment of creditors and a deteriorating debtor collection rate. An assessment in this regard was not made by management, and the financial statements and notes thereto do not disclose this fact.

**Disclaimer of opinion**

26. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on these financial statements.

**Emphasis of matter**

27. I draw attention to the matter below. My opinion is not modified in respect of this matter:

**Restatement of corresponding figures**

28. As disclosed in note 31 to the financial statements, the corresponding figures for 30 June 2009 have been restated as management corrected misstatements in the opening balances for certain debtors' and creditors' opening balances, resulting from prior year audit findings in the preparation of the 2009-2010 financial statements.

**Additional matters**

29. I draw attention to the matters below. My opinion is not modified in respect of these matters:

**Unaudited supplementary schedules**

30. The supplementary information set out on pages XX to XX do not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

**Material inconsistencies in other information included in the annual report**

31. I acknowledge receipt of the draft annual report which contained inconsistencies with the audited financial information. The final annual report in terms of section 127(2) of the MFMA will be reviewed on receipt.

## REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

32. As required by the PAA and in terms of *General Notice 1570 of 2009* issued in *Government Gazette 32758 of 27 November 2009*, I include below my findings on the report on predetermined objectives, compliance with the following key laws and regulations ((Local Government: Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA) and MFMA)), and financial management (internal control).

**Predetermined objectives**

33. Material findings on the report on predetermined objectives, as set out on pages XX to XX, are reported below:

**Non-compliance with regulatory and reporting requirements**

**Local Government: Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA)**

34. The municipality's integrated development plan (IDP) was not advertised within 14 days of adoption, as required by section 25(4) of the MSA.

35. Key performance indicators, as set out in the IDP were not measurable, relevant, objective and precise, as required by sections 26(i) and 4(1)(a-d) of the MSA.

36. The annual performance report did not contain any information on the performance of external service providers, as required by section 46(1)(a) of the MSA.

**Lack of effective, efficient and transparent systems and internal controls regarding performance management**

37. A performance management policy has not been adopted, approved and implemented during the year, as required by section 38 of the MSA.

38. There is no proof that the municipality's performance management system has been reviewed, as required by section 40 of the MSA.

**Existence and functioning of a performance audit committee**

39. There is no evidence that performance reviews, as required by section 41(c) of the MSA, were undertaken during the year. Furthermore, there is no evidence of quarterly reviews being undertaken by the performance audit committee.

40. **Internal auditing of performance measurements**No internal auditing of performance measurements were performed, as required by section 45(a) of the MSA.

**No mid-year budget and performance assessments**

41. No mid-year performance assessments were undertaken by the accounting officer, as required by section 72(1)(h) of the MFMA SA.

**Usefulness of reported performance information**

42. The following criteria were used to assess the usefulness of the planned and reported performance:

- Consistency: Has the municipality reported on its performance with regard to its objectives, indicators and targets in its approved integrated development plan, i.e. are the objectives, indicators and targets consistent between planning and reporting documents?

- Relevance: Is there a clear and logical link between the objectives, outcomes, outputs, indicators and performance targets?

- Measurability: Are objectives made measurable by means of indicators and targets? Are indicators well defined and verifiable, and are targets specific, measurable, and time bound?

The following audit findings relate to the above criteria:

**Planned objectives, indicators and targets not relevant to the mandate and or objectives of the entity**

43. Management has not taken the municipality's mission and mandate into consideration when developing objectives, as more than 80% of measureable objectives do not relate to the municipality's mission and goals as per the approved 2009-2010 IDP.

**Planned and reported indicators/measures not well defined**

44. Planned and reported outcomes were not well defined as measurable objectives and indicators as per the report on predetermined objectives were not aligned to the IDP.

**Reliability of reported performance information**

45. The following criteria were used to assess the reliability of the planned and reported performance:

- Validity: Has the actual reported performance occurred and does it pertain to the entity i.e. can the reported predetermined performance objectives be traced back to the source data or documentation?

- Accuracy: Amounts, numbers and other data relating to reported actual performance has been recorded and reported appropriately.

- Completeness: All actual results and events that should have been recorded have been included in the reported predetermined objectives.

The following audit findings relate to the above criteria:

**Reported information not consistent with planned objectives, indicators and targets**

46. Final reported objectives as per the report on predetermined objectives differed from objectives recorded in the IDP, which indicates that possible changes could have occurred during the year. There is no evidence that these changes have been approved.

**No supporting source documentation**

47. Inadequate/no supporting source documentation existed to support the completeness and validity of information presented in the report on predetermined objectives.

**Compliance with laws and regulations**

**Local Government: Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA)**

**The accounting officer did not adhere to his statutory responsibilities**

48. The accounting officer did not within 30 days after the end of each quarter, prepare and submit a consolidated report of all withdrawals made during 2009/2010 to council, Provincial Treasury or to the Auditor-General, as required by section 11(4) of the MFMA.
49. There is no evidence that reports were prepared, submitted and reviewed, as required by section 54(1) and section 72 of the MFMA.
50. Monthly reports were not submitted to Provincial Treasury within 10 working days after each month, as required by section 71 of the MFMA.
51. The municipality failed to submit, at the start of the financial year, banking details to the Provincial Treasury and Auditor-General, as required by section 9 of the MFMA.
52. Notification of the bank overdraft was not sent to National Treasury, as required by section 70(2) of the MFMA.

**Supply Chain Management legislative requirements were not implemented or not adhered to**

53. Performance of contractors were not monitored monthly or at all, as required by section 116(2)(b) of the MFMA.
54. Delegations of authority were not approved and implemented, as required by section 79 of the MFMA.
55. Payments have been made to suppliers before final approval takes place of payment documentation, contrary to section 65(2)(a) of the MFMA.

**The financial statements were not prepared in accordance with applicable legislation**

56. A fraud prevention plan was not approved and implemented, as required by section 62(1)(c)(i) of the MFMA.

57. Policies and procedures for major financial cycles was not approved during the year, as required by section 62(1)(f) of the MFMA.

58. The municipality had to make material adjustments to the annual financial statements submitted for audit on 31 August 2010. These adjustments constitute non-compliance with section 122(1) of the MFMA.

**The mayor did not adhere to his legislative responsibilities**

59. The SDBIP was not approved within 14 days of approval of the annual budget, in accordance with section 69(3) of the MFMA.

60. The municipality did not administer its budget effectively and efficiently, as required by sections 70(1)(a) and (b) of the MFMA, which has resulted in unauthorised expenditure.

61. Management did not make any assessments to ascertain whether the municipality is undergoing serious financial problems, as required by section 138 of the MFMA.

**The audit committee was not properly established or not functioning properly**

62. Due to the late appointment of the internal audit, the audit committee did not substantially fulfil all its duties relating to its oversight role over internal audit during the year, as required by section 166 of the MFMA.

**The internal audit unit was not properly established or not functioning properly**

63. The internal audit was only appointed at the end of January 2010 and as a result did not substantially fulfil all its responsibilities for the year, as required by section 166(2)(a)(i) of the MFMA.

## INTERNAL CONTROL

64. I considered internal control relevant to my audit of the financial statements and the report on predetermined objectives as well as compliance with the following key laws and regulations (MSA and MFMA), but not for the purpose of expressing an opinion on the effectiveness of internal control.

65. The matters reported are limited to the significant deficiencies that gave rise for the Basis for disclaimer of opinion paragraph, the findings on the report on predetermined objectives as well as the findings on compliance with laws and regulations.

- **Leadership**

  Management has failed to adopt an appropriate tone at the top to ensure that supervision, review and monitoring of the municipality's processes were undertaken, so as to ensure that controls were implemented and functioning effectively and efficiently as well as consistently during the year under review.

- **Financial and performance management**

  The municipality's financial and performance management processes were inadequate and/or not implemented at all, which resulted in the numerous financial and control related weaknesses identified and reported on during the audit process.

- **Governance**

  Key aspects of ensuring proper governance was absent or inadequate, thus appropriate action was not taken to identify weaknesses in internal controls and mitigate the risks in a timely manner.

## OTHER REPORTS

### Investigation in progress

66. An investigation into financial misconduct and embezzlement of municipal funds involving the suspended chief financial officer is still in progress.

Pietermaritzburg

30 November 2010

AUDITOR-GENERAL
SOUTH AFRICA

*Auditing to build public confidence*